

## Message Text

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ACTION EA-09

INFO OCT-01 IO-13 ISO-00 SP-02 USIA-15 AID-05 EB-07 NSC-05

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COME-00 FRB-01 INR-07 NSAE-00 XMB-04 OPIC-06 LAB-04

SIL-01 L-03 H-02 PA-02 PRS-01 /111 W

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R 140820Z SEP 76

FM AMEMBASSY SEOUL

TO SECSTATE WASHDC 9437

INFO U.S. MISSION GENEVA 379

USDEL MTN GENEVA

AMCONSUL HONG KONG

UNCLAS SECTION 1 OF 2 SEOUL 7307

HONG KONG FOR FINATT

E.O. 11652: N/A

TAGS: ECON, ETRD, KS

SUBJECT: PROPOSED KOREAN TAX REFORM

SUMMARY: THE MINISTRY OF FINANCE HAS ANNOUNCED THAT THE ROKG WILL SUBMIT TO THE UPCOMING SESSION OF THE NATIONAL ASSEMBLY A PROPOSED TAX REFORM PACKAGE WHICH WOULD, INTER ALIA, REDUCE TAXES ON INCOME EFFECTIVE JANUARY 1, 1977 AND INTRODUCE A VALUE ADDED TAX BEGINNING JULY 1, 1977. TAXES ON INCOME WOULD BE REDUCED BY AN AVERAGE OF 23 PERCENT FOR ALL WAGE EARNERS AND THE MINIMUM TAXABLE WAGE WOULD BE RAISED FROM 15,000 TO 20,000 WON FOR MONTH. THE 13 PERCENT VAT WOULD REPLACE MOST INDIRECT TAXES, BUT A SPECIAL EXCISE TAX WOULD BE IMPOSED ON "LUXURY" GOODS. OTHER PROPOSED CHANGES INCLUDE THE STAGED INTRODUCTION OF A TARGET 20 PERCENT UNIFORM TARIFF RATE, AND MEASURES TO FOSTER SOCIAL WELFARE BY INCOME TAX DEDUCTIONS AND ECONOMIC DEVELOPMENT BY EXTENDING BREAKS ON CORPORATE TAXES. ALTHOUGH SOME TAXES WOULD BE REDUCED, THE NET EFFECT OF ALL THE CHANGES WOULD STILL BE AN INCREASE IN THE TAX BURDEN FROM 18.6 PCT

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OF GNP IN 1976 TO 21.5 PERCENT IN 1981. THE ROKG ESTIMATES

THAT THE NEW TAX SYSTEM SHOULD LEAD TO A 36 PERCENT INCREASE IN REVENUE IN 1977, WHICH WILL PERMIT INCREASED GOVERNMENT SPENDING, PARTICULARLY FOR SOCIAL WELFARE AND DEFENSE. END SUMMARY.

1. ON AUGUST 25, THE MINISTRY OF FINANCE (MOF) ANNOUNCED A PROPOSED TAX REFORM PACKAGE WHICH WILL BE SUBMITTED TO THE NEXT SESSION OF THE NATIONAL ASSEMBLY SCHEDULED FOR SEPTEMBER 20. FULL IMPLEMENTATION WOULD REQUIRE THE PASSAGE OF FOUR NEW TAX LAWS AND AMENDMENTS TO 14 EXISTING LAWS. THIS IS THE SECOND MAJOR TAX OVERHAUL IN KOREA IN THE PAST TWO YEARS. (IN 1974 THE GLOBAL INCOME TAX WAS PASSED AND WENT INTO EFFECT IN 1975). THE NEW REFORM (A) INTRODUCES THE VALUE ADDED TAX TO REPLACE A CUMBERSOME SYSTEM OF EXCISE TAXES AND (B) ADJUSTS THE INCOME TAX SCHEDULE SO AS TO OFFSET THE INCREASED TAX BURDEN DUE TO THE VAT AND TO THE INCREASE IN MONEY WAGES THAT HAS TAKEN PLACE SINCE THE GLOBAL INCOME TAX WENT INTO EFFECT.

2. PERSONAL INCOME TAX RATES WOULD BE LOWERED FOR ALL LEVELS OF INCOME. THE FOLLOWING TABLE SHOWS PRESENT AND PROPOSED TAXES BASED ON SELECTED MONTHLY INCOMES FOR A "STANDARD" FAMILY OF 5.

#### INCOME TAX RATES

##### MONTHLY

INCOME	CURRENT		REVISED		REDUCTION
(IN 1,000 WON)	TAX	RATE	TAX	RATE	AMOUNT PER- CENTAGE

80	W 800	1.0	-	-	W 800 100
90	1,600	1.8	800	0.9	800 50
100	2,600	2.6	1,600	1.6	1,000 38.4
110	3,600	3.3	2,400	2.2	1,200 33.3

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120	4,800	4.0	3,300	2.7	1,500 31.2
130	6,000	4.6	4,300	3.3	1,700 28.3
140	7,500	5.4	5,300	3.8	2,200 29.3
150	9,000	6.0	6,300	4.2	2,700 30.0

160	10,800	6.7	7,500	4.7	3,300	30.5
170	12,600	7.4	8,700	5.1	3,900	30.9
180	14,700	8.2	9,900	5.5	4,800	32.6
190	16,800	8.8	11,250	5.9	5,550	33.0
200	19,100	9.5	12,750	6.4	6,350	33.2
250	33,100	13.2	21,150	8.4	11,950	36.1
300	49,600	16.5	31,900	10.6	17,700	35.6
350	68,600	19.6	44,900	12.8	23,700	34.5
400	88,600	22.1	59,900	15.0	28,700	32.3
450	108,600	24.1	77,400	17.2	31,200	28.7
500	130,100	26.0	95,900	19.2	34,200	26.2
600	175,100	29.2	135,900	22.6	39,200	22.3
700	221,600	31.7	176,900	25.3	44,700	20.1
1,000	371,600	37.2	317,900	31.8	53,700	14.4

THE BASIC EXEMPTION FOR EARNED INCOME WOULD BE RAISED FROM 15,000 WON PER MONTH TO 20,000 AND THE LEVEL OF TAX FREE BONUS PAYMENTS FROM 140,000 WON PER YEAR TO 240,000. ALSO PROPOSED IS THE REDUCTION OF THE NUMBER OF CHILDREN ALLOWED AS DEDUCTIONS FROM THREE TO TWO. FURTHER, THE GOVERNMENT WOULD PERMIT UNCLASSIFIED

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TAX DEDUCTIONS FOR MEDICAL INSURANCE PREMIUMS AND FOR LIFE INSURANCE PREMIUMS OF UP TO 120,000 WON PER YEAR OR FOR ALL LIFE INSURANCE PREMIUMS FOR THOSE EARNING 300,000 WON OR LESS PER MONTH. A DEDUCTION FOR 15 PERCENT OF TOTAL NEW SAVINGS WOULD ALSO BE PERMITTED. EDUCATIONAL EXPENSE ALLOWANCES GRANTED BY EMPLOYERS AND OTHER BENEFITS SUCH AS MEALS, UNIFORMS AND MEDICAL SUBSIDIES WOULD BE EXCLUDED FROM TAX.

3. THE MOST FUNDAMENTAL CHANGE WOULD BE BROUGHT ABOUT BY THE INTRODUCTION OF THE VALUE ADDED TAX. THE VAT WOULD REPLACE 11 EXISTING INDIRECT TAXES AND WOULD LEAVE ONLY THOSE IN LIQUOR, TELEPHONE SERVICES AND A STAMP DUTY. THE BASIC RATE OF 13 PERCENT WOULD BE ADJUSTABLE BY 5 PERCENTAGE POINTS UP OR DOWN, AND WOULD BE APPLIED TO ALL TRANSACTIONS EXCEPT EXPORTS, BASIC NECESSITIES AND PERSONAL SERVICES. FOR SMALL ENTER-

PRISES WHICH HAVE GROSS RECEIPTS OF 12 MILLION WON PER YEAR OR LESS THE VAT WOULD BE 2 PERCENT OF GROSS RECEIPTS AND WOULD BE FORGIVEN FOR THOSE WITH TAXES OF LESS THAN 15,000 WON PER YEAR. ON TOP OF THE VAT THERE WOULD BE A SPECIAL EXCISE TAX ON "LUXURY" CONSUMER GOODS. THE SPECIAL TAX WOULD BE IMPOSED ON 31 ITEMS IN 10 RATES. THE VAT DIFFERS FROM THE EXCISE TAXES NOW IN FORCE IN THAT IT IS APPLIED TO EACH STAGE OF PROCESSING OF AN ARTICLE FOR THAT PART OF THE PRICE OF THE ARTICLE ADDED DURING THAT STAGE OF PROCESSING. PRESENT EXCISE TAXES ARE COLLECTED FROM THE MANUFACTURER ON GROSS SALES. PLANS FOR THE INTRODUCTION OF THE VAT HAVE BEEN UNDER FORMULATION FOR SEVERAL YEARS. BY THE VAT THE ROKG HOPEE TO BE ABLE TO SIMPLIFY TAX ADMINISTRATION AND THEREBY INCREASE TAX REVENUES. IT ALSO SEES THE VAT AS A MEANS TO GREATER RESPONSIVENESS OF THE REVENUE SYSTEM TO TRENDS IN THE ECONOMY BE NARROWING THE LAG BETWEEN LIABILITY AND COLLECTION OF TAXES. IF ADOPTED, THE VAT WOULD GO INTO EFFECT JULY 1, 1977 ALTHOUGH ACTUAL IMPLEMENTATION WILL DEPEND ON A PRESIDENTIAL DECREE ISSUED SUBSEQUENT TO THE PASSAGE OF THE LEGISLATION.

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FM AMEMBASSY SEOUL

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INFO U.S. MISSION GENEVA 380

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UNCLAS SECTION 2 OF 2 SEOUL 7307

HONG KONG FOR FINATT

4. THERE IS ALSO A PROPOSAL FOR THE INTRODUCTION OF A UNIFORM IMPORT TARIFF RATE OF 20 PERCENT. THIS WOULD HELP TO CLEAN UP A COMPLICATED SET OF TARIFF RATES, ALTHOUGH THE SHIFT TO THE NEW SYSTEM WOULD BE EFFECTED OVER TIME. THE COMPLEX NON-TARIFF BARRIERS PRESENTLY IN FORCE TO CONTROL THE IMPORT OF CONSUMER GOODS EVENTUALLY WOULD BE PHASED OUT AND RATES PRESENTLY LOWER THAN 20 PERCENT WOULD BE GRADUALLY RAISED. MOST GREATLY AFFECTED, SINCE GOODS WITH VERY HIGH CURRENT RATES WILL CONTINUE TO BE RESTRAINED, WILL BE RAW MATERIALS AND CAPITAL GOODS WHICH PRESENTLY HAVE VERY LOW TARIFF RATES. IF APPLIED ACROSS THE BOARD, THE PROPOSED RATE WOULD HAVE A SIGNIFICANT EFFECT ON THE COST OF IMPORTED MATERIALS, ESPECIALLY THOSE FOR EXPORT INDUSTRIES WHICH NOW ENJOY LOWER TARIFFS.

5. THE PROPOSED PACKAGE CONTAINS SEVERAL MEASURES TO INCREASE SOCIAL WELFARE. BESIDES ALLOWING PERSONAL DEDUCTIONS FOR WORKERS' WELFARE ITEMS, THE CHANGES WOULD:

A. EXEMPT PRIVATE SCHOOLS FROM REGISTRATION TAXES AND TAXES  
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ON INCOME FROM OTHER BUSINESS SOURCES;

B. EXEMPT VOCATIONAL TRAINING FACILITIES FROM CORPORATE TAX AND OTHER TAXES;

C. INCREASE THE BASIC EXEMPTION FOR INHERITANCE TAXES FROM 14.3 MILLION WON TO 21.8 MILLION WON AND EXEMPT PROPERTY SUCH AS HOUSING FROM INHERITANCE TAX. IN ADDITION THE DEDUCTION FOR LIFE INSURANCE WOULD BE RAISED AND A DEDUCTION FOR TRUSTS ESTABLISHED.

D. EXEMPT FARM LAND TRANSFERS FROM CAPITAL GAINS TAX.

6. OTHER MODIFICATION WOULD AID ECONOMIC DEVELOPMENT. AMONG THEM ARE:

A. SELECTIVE TAX INCENTIVES FOR FOREIGN INVESTMENT (TO BE INCLUDED IN OVERALL REVISION OF INVESTMENT INCENTIVE LAWS);

B. EXTENDING THE SCOPE OF TAX EXEMPTIONS FOR THE SHIPBUILDING INDUSTRY TO VESSELS OF UP TO 10 THOUSAND TONS;

C. INCREASED TAX INCENTIVES FOR THE LIVESTOCK INDUSTRY BY WAY OF FULL TAX HOLIDAYS FOR 3 YEAR AND HALF TAX HOLIDAYS FOR 2 ADDITIONAL YEARS;

D. SPECIAL INCENTIVES FOR RESEARCH AND DEVELOPMENT AS WELL AS THE INTRODUCTION OF NEW TECHNOLOGY BY ALLOWING DEDUCTIONS FOR A RESERVE FOR TECHNOLOGY DEVELOPMENT, SPECIAL DEPRECIATION FOR RESEARCH FACILITIES AND DUTY FREE ENTRY OF RESEARCH MATERIALS;

E. ENLARGING THE SCOPE OF NON-TAXABLE RESERVES THAT MAY BE ESTABLISHED BY CORPORATIONS TO INCLUDE RESERVES FOR PRICE FLUCTUATIONS, FACILITIES LEASES, SPECIAL REPAIRS, RETIREMENT ALLOWANCES AND FOREIGN INVESTMENT;

F. ENCOURAGING THE ESTABLISHMENT OF SMALL AND MEDIUM INDUSTRIES BY EXEMPTING THEM FROM REGISTRATION TAXES, INCREASING THE SPECIAL DEPRECIATION ALLOWANCE AND ALLOWING A RESERVE FOR FACILITIES REPLACEMENT;

G. RESTRUCTURING INCENTIVE CORPORATE TAX RATES FOR CORPORATIONS  
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WHICH SELL EQUITY TO THE PUBLIC; AND

H. REVISING ACCOUNTING METHODS SO THAT FIRMS WITH FOREIGN LOANS ARE MORE EQUITABLY TAXED FOR EXCHANGE LOSSES.

7. WHILE THE AVERAGE RATE OF PERSONAL INCOME TAX REDUCTION IS A SEEMINGLY HIGH 23 PERCENT, IT IS ESTIMATED THAT THE REDUCTION IN TOTAL INCOME TAX REVENUE WOULD BE ONLY 2 PERCENT OF WHAT THE TOTAL TAX REVENUE COLLECTIONS FOR 1976 WOULD BE. FURTHERMORE, OF THE ESTIMATED 5.3 MILLION WAGE EARNERS IN KOREA ONLY ABOUT 1.2 MILLION ACTUALLY PAY INCOME TAXES, I.E. EARN MORE THAN THE MINIMUM TAXABLE INCOME. AND SINCE THE VAT WILL APPLY MORE WIDELY THAN THE PRESENT SYSTEM OF INDIRECT TAXES, THE OVERALL TAX BURDEN (AS A PERCENTAGE OF GNP) WILL RISE FROM THE EXPECTED 18.6 PERCENT IN 1976, TO 19.4 IN 1977, TO 20.4 PERCENT IN 1979 AND TO 21.5 PERCENT IN 1981. THE ROKG ANTICIPATES THAT TOTAL REVENUES WILL RISE 36 PERCENT IN 1977 OVER THE 1976 LEVEL. THE INCREASED REVENUE WILL ENABLE THE ROKG TO INCLUDE IN NEXT YEAR'S BUDGET INCREASED EXPENDITURES FOR SOCIAL WELFARE PROGRAMS SUCH AS MEDICAL CARE FACILITIES AND FOR EDUCATION. DEFENSE EXPENDITURES WHICH HAVE RISEN 48 PERCENT AND 60 PERCENT IN 1975 AND 1976 RESPECTIVELY WILL CONTINUE TO RISE IN THE YEARS OF THE FOURTH FIVE YEAR PLAN 1977-81.

8. THE REACTION TO THE PROPOSED TAX CHANGES HAS BEEN MIXED. THE FOCUS OF MOST CRITICISM HAS BEEN ON THE ADEQUACY OF THE INCREASE IN THE MINIMUM TAXABLE WAGE AND ON THE REDUCTION IN COME TAX RATES. AMONG OTHERS, REPORTEDLY THE FEDERATION OF KOREAN INDUSTRIES AND MEMBERS OF THE RULING DEMOCRATIC REPUBLICAN PARTY HAVE RECOMMENDD THAT THE MINIMUM TAXABLE WAGE BE RAISED BY AT LEAST 10,000 WON OVER THE ROKG PROPOSED AMOUNT. (OTHER CRITICS HAVE OPPOSED RAISING THE MINIMUM TAXABLE WAGE, SINCE, BASED ON THE ABSOLUTE AMOUNT OF REDUCTIONS FOR WAGE EARNERS, IT APPEARS THAT THE HIGHER SALARIED BENEFIT MORE THAN THE LOWER, E.G. A WORKER WITH A MONTHLY WAGE OF 100,000 WON GETS A REDUCTION OF 1,000 WON PER MONTH WHEREAS ONE RECEIVING

200,000 PER MONTH GETS 6,350 WON PER MONTH AND ONE WITH  
500,000 WON PER MONTH GETS 34,200 WON PER MONTH. MOREOVER,  
OTHER MORE REGRESSIVE TAXES ARE RAISED TO MORE THAN OFFSET THE  
REVENUE LOST FROM TAXES ON INCOME.) PUBLIC ARGUMENT FOR  
INCREASING THE MINIMUM TAXABLE WAGE CENTERS ON THE INCREASE IN  
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WAGES SINCE THE GLOBAL INCOME TAX WENT INTO EFFECT IN 1975.  
CRITICS OF THE ROKG PROPOSAL CLAIM THAT NOMINAL WAGES HAVE  
RISEN TO AN EXTENT THAT WOULD PUT MANY MORE WORKERS' SALARIES  
ABOVE THE MINIMUM TAXABLE LEVEL BUT THAT THE RATE OF INFLATION  
AND THE TAXES NOW LEVIED ON WORKERS SALARIES COMBINE TO REDUCE  
REAL WAGES. IT WOULD APPEAR THAT THESE CRITICISMS HAVE HAD SOME  
IMPACT. WHEN WE WERE GIVEN AN OUTLINE OF THE PROPOSED REFORMS  
BY CHO JOONG-HYUNG, DIRECT TAX AFFAIRS OFFICER OF THE  
MINISTRY OF FINANCE, HE FIRST TORE OUT THE INCOME TAX SCHEDULES,  
EXPLAINING THAT THEY WERE NO LONGER APPLICABLE.  
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